No. 21,146

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellant,

v.

NATIONAL SECURITIES, INC., a corporation, NATIONAL LIFE & CASUALTY INSURANCE COMPANY, a corporation, ROBERT A. WALLACE, ROBERT C. BOHANNAN, JR., ARTHUR W. SAFFERT, TED WILKINS, JOHN S. BARRETT, JOSEPH B. SETTER, BREEFERD W. LARGE, JR. and PRODUCERS LIFE INSURANCE COMPANY, a corporation (also known as NATIONAL PRODUCERS LIFE INSURANCE COMPANY),

Defendants-Appellees.

APPEAL FROM UNITED STATES DISTRICT COURT FOR THE DISTRICT OF ARIZONA (Phoenix Division)

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF-APPELLANT

PHILIP A. LOOMIS, JR.
General Counsel

DAVID FERBER
Solicitor

EDWARD B. WAGNER
Special Counsel

MARTIN D. NEWMAN
Attorney

Securities and Exchange Commission
Washington, D. C. 20549

W. STEVENS TUCKER
Special Counsel

Securities and Exchange
Commission
San Francisco, California
94102

FILED

FEB 6 1967

WM. B. LUCK, CLERK

I N D E X

TABLE OF CASES

Cases:

Cases—continued Page

Cases—continued — Page

Statutes and Rules:

Statutes and Rules—continued — Page

Miscellaneous—continued

No. 21,146

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellant,

v.

NATIONAL SECURITIES, INC., a corporation, NATIONAL LIFE & CASUALTY INSURANCE COMPANY, a corporation, ROBERT A. WALLACE, ROBERT C. BOHANNAN, JR., ARTHUR W. SAFFERT, TED WILKINS, JOHN S. BARRETT, JOSEPH B. SETTER, BREEFERD W. LARGE, JR. and PRODUCERS LIFE INSURANCE COMPANY, a corporation (also known as NATIONAL PRODUCERS LIFE INSURANCE COMPANY),

Defendants-Appellees.

APPEAL FROM UNITED STATES DISTRICT COURT FOR THE DISTRICT OF ARIZONA (Phoenix Division)

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF-APPELLANT

STATEMENT OF PLEADINGS AND JURISDICTION

This is an appeal under 28 U.S.C. 1291 by the plaintiff Securities and Exchange Commission from a final judgment of the United States District Court for the District of Arizona (Phoenix Division) granting judgment on the pleadings for the defendants-

appellees (R. 804).[1/] The action was brought pursuant to Section 21(e) of the Securities Exchange Act of 1934, 15 U.S.C. 78u(e), to enjoin violations of the antifraud provisions of that Act, Section 10(b), 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 CFR 240.10b-5, and for other relief (R. 2, 12-14, 424, 440-442). The complaint alleges that the defendants, in the course of violating the Act, made use of the means and instrumentalities of interstate commerce and of the mails (R. 3, 425). The district court had jurisdiction under Section 27 of the Act, 15 U.S.C. 78aa (R. 2, 424).

STATEMENT OF THE CASE

Proceedings Below

The Commission's initial complaint for an injunction (R. 1-14) alleged, inter alia, that the defendants, National Securities, Inc., ("National Securities") and its subsidiary, National Life and Casualty Insurance Company ("National Life"), together with certain individual defendants who were officers and employees of National Securities, National Life, or both, had entered into a plan or scheme to obtain control of Producers Life Insurance Company ("Producers Life") and subsequently to bring about the consolidation of Producers Life and National Life in violation of Section 10(b) and Rule 10b-5

1/ References to the Record Appendix are cited as "R. ."

(R. 3-5).[2/] The Commission at the time its complaint was filed moved for a temporary restraining order and a preliminary injunction because the plan was about to consummated (R. 15-16). The temporary restraining order was granted (R. 108-111). The defendants filed answers denying generally the allegations of the complaint (R. 170-177). They also moved that the temporary restraining order in part be vacated (R. 292-293). Their motion was granted (R. 293) and the questioned corporate consolidation of National Life and Producers Life was then ratified by their respective shareholders and approved by the Director of Insurance of the State of Arizona (R. 437-439).

The district court thereafter entered an order authorizing the Commission to "serve and file" an amended and supplemental complaint (R. 420) and the Commission filed such a complaint, re-alleging the violations previously set forth, together with several additional violations and subsequent developments, and asking in addition to injunctive relief that the defendants take whatever steps might be necessary to rectify the consequences of their unlawful conduct,

---

2/ The complaint also named as defendants four of the former directors of Producers Life and a corporation they controlled, Producers Thrift & Loan Company ("Producers Thrift"), all referred to herein as "the selling directors." The complaint against these defendants was dismissed on their motion (R. 291) and a subsequent motion of the Commission (R. 494-495) to amend a later complaint to add them as parties defendant was denied (R. 793-794). No appeal has been taken from this denial. References to the defendants in the text relate only to the other defendants.

including an accounting and a readjustment of "the respective equities of the defendants and the stockholders of Producers Life" (R. 423-442; 441). The defendants filed an answer (R. 467-473) and moved for judgment on the pleadings or, in the alternative, for summary judgment (R. 474). On February 14, 1966, the court granted defendants' motion for judgment on the pleadings (R. 801).

The Allegations of the Amended and Supplemental Complaint

The Commission's Amended and Supplemental Complaint alleged that Producers Life had been an Arizona life insurance company, operating in that state and other western states (R. 424); it had 880,000 shares outstanding (including 50,203 of treasury stock), most of which were held by approximately 14,000 stockholders throughout the United States (R. 425, 431). The defendant National Life, also an Arizona life insurance company which operated in that state and other western states, was controlled by the defendant National Securities, a holding company which owned two-thirds of its stock (R. 424). According to the complaint, the defendants pursuant to a preconceived scheme and in violation of Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder (1) purchased control of Producers Life, inter alia, by acquiring its treasury stock for a consideration which was designed to appear fair but which was in reality largely illusory because the defendants intended to and did reimpose obligations assumed by them in the purchase upon the

successor company into which they intended to consolidate Producers Life, and (2) solicited the approval of the stockholders of Producers Life to the plan of consolidation by means of material misrepresentations and omissions.

On April 27, 1964, it was alleged, National Securities first purchased 66,310 shares of Producers Life from four directors of the latter company (and Producers Thrift, their controlled company) for $942,769 in cash (R. 429).[3/] In addition, National Securities agreed to pay the selling directors $979,000 in monthly installments over a 10-year period for agreements not to compete with Producers Life in the future (R. 428-429). National Securities simultaneously purchased 50,203 shares of treasury stock of Producers Life for $114,964 in cash or $2.29 per share plus the assumption of certain of its outstanding liabilities in the amount of $627,891 or $12.50 per share, representing obligations of Producers Life to make payments for prior agreements not to compete (R. 428).[4/] It is alleged that at the time of these purchases the

---

3/ National Securities purchased 27,416 shares of Producers Life stock from the four directors for $570,000 or approximately $20.79 per share, and 38,894 shares from Producers Thrift for $372,769, or approximately $9 per share (R. 429).

4/ Both the minutes of the board of directors meeting on April 27, 1964, at which Producers Life was authorized to sell the above treasury stock, and a management agreement by which Producers Life turned control of its operations over to National Securities, indicate that a consolidation of Producers Life into National Securities or its subsidiary was then contemplated (R. 41, 73).

defendants intended, as part of their unlawful scheme, to reimpose the initial obligation of payment of these assumed liabilities upon the successor to Producers Life after its planned consolidation with National Life, and thus relieve National Securities of any payments to be made upon these liabilities (R. 428). The shares of Producers Life so acquired, together with additional shares owned by National Securities, were transferred by National Securities to its subsidiary, National Life, for $1,114,964 in May 1964 (R. 430). When Producers Life was subsequently consolidated with National Life, the consolidated company assumed National Securities' obligations to the selling directors of Producers Life and the obligations, previously assumed by National Securities, to make payments for the prior agreements of Producers Life not to compete (R. 433-434). Prior to that time, through resignation of its former directors and appointment of certain of the individual defendants as directors by National Securities, the affairs of Producers Life had become completely dominated by National Securities (R.431), as were the affairs of National Life.

By virtue of paragraph 24 of the plan of consolidation of Producers Life and National Life, the successor company, National Producers Life Insurance Company ("National Producers"), was required to reimburse National Securities from gross revenues for any sums paid by the latter on the obligations it had incurred or assumed under the non-compete agreements. Through this plan National Securities would be reimbursed for a substantial part of its cost of Producers Life by payments from the company into which Producers Life was to be consolidated (R. 432-434).

The plan of consolidation was approved by the directors of the constituent companies and thereafter a communication soliciting proxies together with a copy of the consolidation agreement and a notice of the special stockholders meeting was mailed by the management of Producers Life to its 14,000 stockholders (R. 433). This communication and subsequent material (R. 433-439) sent to stockholders were alleged to have failed to disclose material information and to have contained false and misleading statements, including the following:

1. Omission to Reveal Amounts Being Assumed by the Successor Corporation on the Non-Compete Agreements. There was no disclosure of the amount owed by National Securities on the non-compete agreements — totalling over 1,400,000 dollars — which was to become a continuing charge against the income of National Producers (R. 433-434).

2. Predicted 1965 Earnings and Omissions of 1964 Losses. There were specific and repeated predictions that net income for National Producers would be $460,000 in the year 1965 (R. 435, 605, 624, 629). As late as February 23, 1965, it was represented (R. 636, 638):

> "Our projected profits from operations for 1965 of $460,000 are possible only through operational economies that can be effected as a result of the merger. This is twice the total profits for the past five years for Producers Life. Or, to put it another way, this is ten times the average annual profits of your company for that period. . . ."

National Life had a loss from operations of $35,657 for the year ending December 31, 1964, and Producers Life had a loss from operations of $69,716 for that year.[5/] After becoming aware of these losses and

---

5/ Excerpts from Ex. 15, p. 47; excerpts from Ex. 13, p. 4.

without disclosing them, the defendants continued to solicit proxies to be voted in favor of the merger, referring to the $460,000 earnings prediction for 1965, which was based on 1963 income (R. 638). Statements of comparative income and losses for the two companies for the years 1959 through 1963 were also communicated to the stockholders in connection with the earnings prediction but no mention was made of the substantial losses suffered by both companies in the immediately preceding year (R. 437).

3. Inclusion of Treasury Stock as an Asset Value of $1,175,085.75 in the Pro Forma Balance Sheet of National Producers. An illusory asset of "Treasury Stock $1,174,556" was set forth in the pro forma balance sheet for National Producers (R. 435).

4. Concealment of Material Facts Relating to Valuation of Shares of Producers Life Held by National Life. In a comparative balance sheet sent to Producers Life stockholders on November 27, 1964, the stock of Producers Life held by National Life was listed as an asset of National Life valued at $1,174,556, the amount National Life had paid National Securities (R. 435). National Life reported this asset in its 1964 annual report to the Arizona Director of Insurance, however, at its December 31, 1964 market value of $641,668, and charged off $579,381 to surplus (R. 437; Excerpts from Ex. 14, p. 30A; Excerpts from Ex. 15, pp. 46, 51). This write-down was not disclosed in any of the communications sent after December 31, 1964, although defendants continued to solicit assents to the merger from the stockholders who had previously received the November 27, 1964 mailing.

The Decision Below

The district court, in granting defendants' motion for judgment on the pleadings, suggested that Section 10(b) of the Securities Exchange Act may not apply to proxy solicitations for "a shareholder-approved corporate consolidation and reorganization," and, although its order is not completely clear, it apparently held (1) that in any event "the McCarran[-Ferguson Insurance Regulation Act, 59 Stat. 33, 15 U.S.C. 1011-1015] . . . preclude[s] the application in this case of §10(b), as implemented by Rule 10b-5" and (2) that "an accounting for unjust enrichment and other relief" sought by the Commission "would, in all events, fall outside the scope of available relief provided in §21(e) of the 1934 Act. . ." (R. 798, 801).

STATUTES INVOLVED

Relevant portions of the Securities Exchange Act of 1934, 15 U.S.C. 78a, et seq., and of Rule 10b-5 promulgated thereunder, 17 CFR 240.10b-5, are printed in an appendix hereto (pages 1a-4a, infra). Also printed in the appendix are relevant portions of the McCarran-Ferguson Insurance Regulation Act, 15 U.S.C. 1011-1015.

SPECIFICATION OF ERRORS

1. The district court erred in granting defendants' motion for judgment on the pleadings on the ground that the McCarran Act precluded

the application of the antifraud provisions of the Securities Exchange Act, Section 10(b), and Rule 10b-5 thereunder.

2. The district court erred in holding that it could not grant relief to "rectify and correct the consequences" of defendants' unlawful conduct and that it would be inappropriate and outside the scope of relief afforded by the Securities Exchange Act for the court to grant, as part of the requested remedy, an accounting for unjust enrichment and other relief.

3. The district court erred to the extent it may have suggested that the fraudulent statements made in connection with the consolidation of Producers Life and National Life into National Producers and the fraudulent omissions in the purchase of Producers Life treasury stock were not "in connection with the purchase or sale" of securities within the meaning of Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder.

SUMMARY OF ARGUMENT

1. The McCarran Act was passed in 1945 to allay fears, based upon a Supreme Court decision[6/] in the prior year, that the regulation of the insurance business would henceforth be taken over by the federal government. It was not intended to, and did not, alter the applicability of the antifraud provisions of the federal securities laws to transactions

---

6/ United States v. South-Eastern Underwriters Association, 322 U.S. 533 (1944).

in the capital stock of insurance companies. The exemptions relating to insurance are specifically stated in the federal securities laws; and in the important cases arising under those laws involving companies subject to state insurance regulation, the questions have related to such matters as whether a "variable annuity" is basically in the nature of an insurance policy or a security. The legislative history of the Securities Acts Amendments of 1964 makes clear that Congress considered the federal securities laws to be applicable to stock in insurance companies. In many cases, including criminal cases, involving charges of fraudulent sales of insurance company stock in violation of the federal securities laws it has not even been contended that the McCarran Act is applicable. While the question has been raised in other cases, except for the decision of the court below, it has never been held that the sale of insurance company stock was included within the "business of insurance" within the meaning of the McCarran Act.

2. The Supreme Court in J. I. Case Co. v. Borak, 377 U.S. 426 (1964), held that, in an action brought under the same jurisdictional provisions as the instant case, the district courts have jurisdiction to grant the type of equitable relief sought here. In fact, the Supreme Court in its opinion admonished the courts "to be alert to provide" whatever remedies may be required to afford appropriate relief. That opinion is consistent with a long line of cases under the federal securities laws and other regulatory statutes which have authorized the

granting of equitable relief to the United States when it is seeking to vindicate the public interest, even though the governing statute does not specifically provide for the granting of such remedies.

3. The terms "purchase" and "sale" are broadly defined in the Securities Exchange Act so as to embrace transactions beyond the limitations applicable under the commercial law of sales. In a consolidation the definitions literally apply since the shareholder disposes of one security and acquires another. The complex nature of a consolidation may enhance the opportunities for fraud and, accordingly, the securities laws to afford relief in such situations must, as the Supreme Court has held, be construed flexibly to effectuate their remedial purposes. While this Court in dicta in a 1943 opinion agreed with the position urged by the Commission at that time in a brief amicus curiae that certain of the antifraud provisions of the Securities Act were not applicable to a corporate consolidation, the Commission since at least 1951 has consistently held that a merger or consolidation involves a purchase or sale of securities within the meaning of the antifraud provisions of the securities laws and has so informed this Court.

The purchase of treasury shares of Producers Life by National Securities, for a purported consideration which included an assumption of a substantial liability of Producers Life that National Securities intended to avoid by causing it to be assumed by the corporation into which it intended and did consolidate Producers Life, also violated Section 10(b) and Rule 10b-5.

ARGUMENT

I. THE McCARRAN ACT DOES NOT IMMUNIZE INSURANCE COMPANIES FROM THE PROVISIONS OF THE FEDERAL SECURITIES LAWS

The McCarran Act declares (15 U.S.C. 1011) that the "continued regulation and taxation by the several States of the business of insurance is in the public interest" and provides (15 U.S.C. 1012(b)) that "[n]o Act of Congress shall be construed to invalidate, impair or supersede" any state law enacted "for the purpose of regulating the business of insurance."

The Act was designed to allay fears, stemming from the Supreme Court's decision in United States v. South-Eastern Underwriters Association, 322 U.S. 533 (1944), that the regulation of the insurance business, which had traditionally been a matter of state and local concern, would be henceforth taken over by the federal government. The Supreme Court's decision in that case had held that the business of insurance conducted across state lines was interstate commerce, with the result, inter alia, that insurance premium rates fixed by agreement could be charged as being in violation of the Sherman Act. The legislative history specifically stated that it was "not the intention of Congress in the enactment of . . . [the McCarran Act] to clothe the

States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the South-Eastern Underwriters Association case." H. Rep. No. 143, 79th Cong., 1st Sess. (1945) 3. In fact, Senator McCarran stated, "in other words, we give to the States no more powers than they previously had, and we take none from them." 91 Cong. Rec. 1442 (1945).

Appellants cannot contend that there was any question as to the application of the federal securities laws to the purchase and sale of securities of insurance companies prior to the passage of the McCarran Act in 1945. The only provisions respecting insurance in these laws related to an exemption from registration under the Securities Act of 1933[7/] for "[a]ny insurance or endowment policy or annuity contract or optional annuity contract" and to an exemption in the Investment Company Act of 1940[8/] to the effect that an insurance company is not an investment company. The troublesome questions that have been raised in this area relate not to whether transactions in the capital stock of insurance companies are subject to the federal securities laws but to whether a particular contract is an annuity policy or a security and whether an entity issuing such a contract is an insurance company or an investment

---

7/ Section 3(a)(8), 15 U.S.C. 77c(a)(8).

8/ Section 3(c)(3), 15 U.S.C. 80a-3(c)(3).

company. See Securities and Exchange Commission v. Variable Annuity Life Insurance Co., 359 U.S. 65 (1959); Prudential Insurance Co. v. Securities and Exchange Commission, 326 F. 2d 383 (C.A. 3, 1964); Securities and Exchange Commission v. United Benefit Life Ins. Co., 359 F. 2d 619 (C.A. D.C., 1966), certiorari granted, 385 U.S. 918 (1966).

The Senate Committee on Banking and Currency recently had occasion to point out: "Stock insurance companies are presently subject to the provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934."[9/] This statement was made in connection with amendments made in 1964 to the Securities Exchange Act, which required registration of the equity securities of the larger over-the-counter companies and extended reporting, proxy and insider-trading provisions to such companies. Securities Acts Amendments of 1964, 78 Stat. 565. From these provisions certain exemptions were made for those insurance companies which would be subject to certain state statutory requirements, since Congress believed such requirements would furnish protections to investors comparable to those imposed under the new law in the case of securities issued by other companies. These exemptions are limited solely to the new requirements relating to periodic reports, proxies, and insider-trading and do not purport to affect other requirements

---

9/ S. Rep. No. 379, 88th Cong., 1st Sess. (1963) 36.

imposed by the various federal securities laws. The context in which these exemptions were made is clear from the Commission's statement filed with the House Committee on Interstate and Foreign Commerce during the hearings:

> "Historically, insurance companies have never been exempted from either the Securities Act of 1933 or the Securities Exchange Act of 1934. Under the Securities Act of 1933, an insurance company distributing its securities to the public must file a registration statement with the Commission and comply with all of the provisions of that act, in the same manner as any industrial company. Likewise, under the Securities Exchange Act, an insurance company listing a security on a national securities exchange must comply with all of the provisions of that act applicable to exchange-listed companies. Presently two insurance companies have a security so listed and comply with those provisions of the act. Moreover, section 15(d) of the Exchange Act, added to that act in 1936, is fully applicable to insurance companies. That section requires an issuer distributing its securities to the public under a Securities Act registration statement to file periodic financial and other reports with the Commission if the value of the securities offered plus the value of all other outstanding securities of the class offered exceeds $2 million. Under section 15(d), approximately 148 insurance companies, including about 96 life insurance companies, file periodic reports with the Commission. . . ." 10/

In most cases under the antifraud provisions of the Securities Exchange Act involving insurance companies no question respecting the

---

10/ Hearings Before A Subcommittee of the House Committee on Interstate and Foreign Commerce on H.R. 6789, H.R. 6793, S. 1642, 88th Cong., 1st Sess. (1963) 176.

McCarran Act has even been raised.[11] So far as we are aware, there have been only two decided cases, in addition to the instant case, where it has been contended that the McCarran Act exempted the sale of stock of insurance companies from the requirements of the federal securities laws: Securities and Exchange Commission v. American Founders Life Insurance Company of Denver, Colorado (Civ. Action No. 6021, D. Colo., order dated May 7, 1958) and United States v. Meade, 179 F. Supp. 868 (S.D. Ind., 1960). Both held that the McCarran Act did not apply. As pointed out in the American Founders case, "the offer for sale, sale and delivery of the capital stock of insurance companies is not 'the business of insurance' within the contemplation of . . . [the McCarran] Act, and thus the offer for sale, sale and delivery of such capital stock is not exempt from the operation of the Securities Act of 1933. . . ."[12]

11/ United States v. National Union Life Insurance Company, S.E.C. Litigation Release No. 2058 (N.D. Ala., 1961) (conviction); Securities and Exchange Commission v. National Reserve Life Insurance Company, S.E.C. Litigation Release No. 2450 (D. Kan., 1962) (decree of permanent injunction); Securities and Exchange Commission v. Decker-Thompson Brokers, Inc., S.E.C. Litigation Release No. 1941 (W.D. La., 1961) (decree of permanent injunction). Brennan v. Midwestern United Life Insurance Company, CCH Fed. Sec. L.Rep. ¶ 91,817 (N.D. Ind., Civ. No. 1716, 1966).

There have been similar actions under the antifraud provisions of Section 17 of the Securities Act. United States v. McCune, S.E.C. Litigation Release No. 2319 (W.D. Wash., 1962); and Securities and Exchange Commission v. American Brokerage Corporation, S.E.C. Litigation Release No. 2615 (D. Wyo., 1963). In neither of these cases was the McCarran Act asserted as a defense.

12/ See also United States v. Sylvanus, 192 F. 2d 96 (C.A. 7, 1951) (Mail Fraud Statute, 18 U.S.C. 1341).

II. THE DISTRICT COURT ERRED IN FINDING THAT IT COULD NOT GRANT THE COMMISSION'S REQUEST FOR ANCILLARY RELIEF

As we have seen, the Commission attempted to enjoin the consolidation of Producers Life and National Life at a time when the stockholders of Producers Life were being subjected to misleading communications urging them to approve the consolidation. The court below appears to have held that, even if the defendants' actions were unlawful, because it vacated the temporary restraining order obtained by the Commission and permitted the consolidation to be effected, it is without power to grant relief which the Commission claims would "rectify and correct the consequences of the wrongful and unlawful conduct of defendants" (R. 796). The court states that such relief, including a "prayer for an accounting for unjust enrichment," would "be inappropriate . . . and would, in all events, fall outside the scope of available relief provided in § 21(e) of the 1934 Act. . . ." (R. 800-801.)[13/]

A comparable situation existed in J. I. Case Co. v. Borak, 377 U.S. 426 (1964), where the plaintiff sought to enjoin a proposed merger, contending that materials circulated to obtain proxies were

---

13/ Should this Court agree with the Commission that the court below had power to undo the consolidation or otherwise grant relief to prevent the defendants from remaining unjustly enriched by their unlawful activities at the expense of former stockholders of Producers Life, to the extent that the court below may have held (R. 800-801) that "an accounting for unjust enrichment" or "other relief" which the Commission sought would be inappropriate "to rectify and correct the consequences of the wrongful and unlawful conduct of defendants," the case could be remanded to the court below to determine what relief would be appropriate.

in violation of Section 14(a), 15 U.S.C. 78n(a), of the Securities Exchange Act and rules of the Commission thereunder, 17 CFR 240.14a-1 through 240.14a-12. Id. at 429. Upon plaintiff's failure to obtain injunctive relief, the merger was consummated. The district court held that it thereafter had no power to grant equitable relief or damages.[14/] The Court of Appeals reversed and was sustained by the Supreme Court, which emphasized that "it is the duty of courts to be alert to provide such remedies as are necessary to make effective the congressional purpose" and that the federal courts should "'adjust their remedies so as to grant the necessary relief' where federally secured rights are invaded." It held that Section 27 of the Securities Exchange Act, which "grants the District Courts jurisdiction 'of all suits in equity and actions at law brought to enforce any liability or duty created by this title. . .'" gave the district courts "power to grant all necessary remedial relief." Id. at 433, 435.

The court's jurisdiction in the instant case was also based on Section 27.

The holding in the Borak case is consistent with a long line of Supreme Court decisions to the effect that once the equitable jurisdiction of a court is invoked in an injunctive action, the court's

---

14/ It suggested that the rule might be otherwise, however, in a suit brought by the Commission. See 377 U.S. at 430. There is no express provision in the Securities Exchange Act for injunctive relief by a private litigant but Section 21(e) provides for such relief in an action by the Commission.

general equity powers permit it to grant complete relief. E.g., United States v. Dupont, 366 U.S. 316, 334 (1961); United States v. Parke, Davis & Co., 362 U.S. 29, 48 (1960); Porter v. Warner Holding Co., 328 U.S. 395, 398 (1946); Yakus v. United States, 321 U.S. 414, 441 (1944); Virginian Ry. Co. v. Federation, 300 U.S. 515, 552 (1937). See also Camp v. Boyd, 229 U.S. 530, 551-552 (1913). And when the United States brings an enforcement proceeding in the public interest, all doubts about ancillary equitable remedies are to be resolved in its favor.[15/]

Accordingly, equitable relief not specifically authorized by the securities laws has repeatedly been made available in actions based upon violations of these laws. Thus, in Deckert v. Independence Shares Corp., 311 U.S. 282 (1940), the Supreme Court held that rescission is a proper remedy under Section 12(2) of the Securities Act. And this Court has held that the general equity power of the district courts, without any specific statutory authority, authorizes the appointment of receivers under the securities laws at the request of the Commission. Securities and Exchange Commission v. Los Angeles Trust Deed & Mortgage

---

15/ In Virginian Ry. Co. v. Federation, supra, the Supreme Court said (300 U.S. at 552):

> "Courts of equity may, and frequently do, go much farther both to give and withhold relief in furtherance of the public interest than they are accustomed to go when only private interests are involved."

Exchange, 285 F. 2d 162, 181-182 (1960), certiorari denied, 366 U.S. 919 (1961).[16/]

In any event at the very least, if the allegations made in the complaint are true, the Commission is entitled to an adjudication that the defendants' conduct violated Section 10(b) and Rule 10b-5, cf. United States v. Parke, Davis & Co., 362 U.S. 29, 48 (1960); and in this setting the Commission is also entitled to a decree enjoining the defendants from arranging or carrying out other consolidations or mergers through similarly deceptive methods.

III. DEFENDANTS' DECEPTIVE ACTS, CONDUCT AND COURSE OF BUSINESS, INCLUDING MAKING OF UNTRUE AND MISLEADING STATEMENTS TO SECURITY HOLDERS OF PRODUCERS LIFE AND CONCEALING MATERIAL FACTS FROM THEM, OCCURRED IN CONNECTION WITH PURCHASES AND SALES OF SECURITIES

In view of the district court's disposition of the case based on its application of the McCarran Act, it made no determination as to the application of Section 10(b) of the Securities Exchange Act or Rule 10b-5 thereunder to the facts alleged. Appellees, however, will presumably urge affirmance alternatively on the ground that even if, as alleged, the plan of consolidation, including the

---

16/ See also, e.g., Lankenau v. Coggeshall & Hicks, 350 F.2d 61 (C.A. 2, 1965); Esbitt v. Dutch-American Mercantile Corp., 335 F.2d 141, 143 (C.A. 2, 1964); Aldred Investment Trust v. Securities and Exchange Commission, 151 F. 2d 254 (C.A. 1, 1945), certiorari denied, 326 U.S. 795 (1946); Securities and Exchange Commission v. H. S. Simmons & Co., 190 F. Supp. 432 (S.D. N.Y., 1961). See 3 Loss 1824-1829 (2d ed. 1961); Cary, Book Review, 75 Harv. L. Rev. 857, 861 (1962).

acquisition of the treasury stock of Producers Life was conceived in fraud and solicitation material sent to security holders of Producers Life was deceptive and misleading, the defendants' conduct was not in connection with the purchase or sale of any securities within the meaning of Section 10(b) and Rule 10b-5. Accordingly, a summary discussion of this point at this time appears appropriate.

A. Defendants' Fraudulent Statements Made in Connection with the Consolidation of Producers Life and National Life into National Producers were Made in Connection with Purchases and Sales of Securities

Section 3(a)(14) of the Securities Exchange Act, 15 U.S.C. 78c(a)(14), provides that a "sale" includes "any contract to sell or otherwise dispose of" securities and Section 3(a)(13), 15 U.S.C. 78c(a)(13), provides that a "purchase" includes "any contract to buy, purchase, or otherwise acquire" securities. Congress thereby made clear that these concepts embrace transactions beyond the limitations ordinarily applicable under the commercial law of sales in order to effectuate a primary purpose of the Act expressed in Section 2, 15 U.S.C. 78b, to make the "regulation and control" of transactions in securities "reasonably complete and effective." When, as here, a shareholder votes on a proposal for consolidation, he is being asked to decide whether to consent to the acceptance of a new security—a security of a new and different company—in exchange for the security he holds. When the consolidation is approved and the exchange of securities

occurs,[17] he has, in fact, disposed of one security and acquired another.[18] Accordingly, there has been both a purchase and sale within the meaning of the statutory definitions quoted from above.[19]

17/ Under the terms of the consolidation agreement, each stockholder of Producers Life was to receive, as a stock dividend, one share of Producers Life stock for every five shares owned by such stockholder. The ratification of this stock dividend by the stockholders of Producers Life was made a condition precedent to the execution of the consolidation agreement. The agreement further provided that each shareholder of National Life would receive one share of Producers Life stock for each share of National Life owned by him. The consolidation agreement, in addition, provided that the consolidated company would be known as National Producers Life Insurance Company. Although the shareholders of Producers Life did not actually surrender their shares, upon the execution of the consolidation agreement their interests and rights were materially changed (R. 446-447).

18/ Cf. Hooper v. Mountain States Securities Corp., 282 F. 2d 195 (1960), certiorari denied, 365 U.S. 814 (1961), where the Court of Appeals for the Fifth Circuit held that a violation of Section 10(b) of the Securities Exchange Act and Rule 10b-5 was perpetrated upon a corporation which exchanged its shares for certain property. The court there stated (282 F. 2d at 203):

> "If this is not a sale in the strict common law traditional sense, it certainly amounted to an arrangement in which Consolidated 'otherwise dispose[d] of' its stock. § 3(a)(14), 15 U.S.C.A. § 78c(a)(14)."

19/ This is also consistent with the use of the verb "include" in the definitions of both "sale" and "purchase" in Section 3(a)(13) and (14) of the Securities Exchange Act, as contrasted to the more limiting verb "means," which is used in most of the definitions set forth in Section 3(a). See Russell, Legislative Drafting and Forms (4th ed. 1938) 40.

The need for the antifraud protections is no less in such a situation than it is in the case of other types of purchases or sales. Indeed, the complex nature of a merger may enhance the opportunities for fraud and thus makes the need for the antifraud protections even greater than in other situations. A primary purpose of the Securities Exchange Act is "to keep the channels of interstate commerce, the mail[s], and national security exchanges pure from fraudulent schemes, tricks, devices, and all forms of manipulation." Hooper v. Mountain States Securities Corporation, supra, 282 F.2d at 202. This purpose would be thwarted if the protections for investors afforded by Section 10(b) and Rule 10b-5 could be avoided by the formalistic view that there was no purchase of the stock of Producers Life nor sale of the stock of National Producers in the consolidation here involved. The Supreme Court has held that the securities laws must be construed "not technically and restrictively, but flexibly to effectuate . . . [their] remedial purposes." Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963). See also Securities and Exchange Commission v. W. J. Howey Co., 328 U.S. 293, 301 (1946). And see Errion v. Connell, 236 F.2d 447 (1956), where this Court held that the Securities Exchange Act created a federal remedy for one who has been defrauded in the sale of his securities.

In the court below the appellees urged that Section 10(b) and Rule 10b-5 did not apply because of this Court's position in National Supply Co. v. Leland Stanford Jr. University, 134 F.2d 689 (1943), certiorari denied, 320 U.S. 773 (1943), which was in accord with the views expressed to this Court by the Commission. In that case this Court held that the plaintiff was estopped by reason of laches from objecting to the corporate consolidation involved. In addition, it stated, "Without going into the matter, we may say that we are in accord with the views of the Commission," 134 F.2d at 694; these had been expressed in an amicus curiae brief which took the position that the corporate consolidation there involved was not a "sale" of securities giving rise to a private cause of action under Sections 12(1) and (2) of the Securities Act of 1933, 15 U.S.C. 77l(1) and (2). While an action under Section 12(2) of that Act is based upon fraud in the sale of securities, at least since 1951 the Commission has consistently taken the position that a merger or consolidation involves a sale of securities within the meaning of the antifraud provisions of the

federal securities laws.[20] This is in contrast to the registration provisions of the Securities Act, as to which the Commission has by rule provided that certain mergers and consolidations shall not be

---

20/ In 1962 the Commission stated to this Court in an amicus curiae brief (p. 8) filed in Sawyer v. Pioneer Mill Company, 300 F.2d 200 (1962), certiorari denied, 371 U.S. 814 (1962):

> "It is the opinion of the Commission that exchanges of securities to effect a corporate merger, such as those involved in this case, constitute purchases and sales of securities within the meaning of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; that neither the language, the rationale nor the purpose of the 'no-sale' rule requires its application here; and to apply the rule to exclude false and misleading solicitations of stockholders' approval for an exchange of their securities from the protection of the anti-fraud provisions of Rule 10b-5 contravenes the congressional intent and exposes public investors to serious risks of loss."

This Court did not reach that question, although re-argument en banc was ordered, possibly because consideration was being given to overruling the above quoted language of the Leland Stanford case. See Ellis v. Carter, 291 F.2d. 270 (C.A. 9, 1961).

deemed to involve sales of securities.[21] Apart from the brief statement of this Court in the Leland Stanford case, so far as we are

---

21/ From 1935 to 1947 the Commission's position that mergers are not subject to the registration provisions appeared in the Note to Rule 5 of Form E-1. In 1947, Form E-1 and the Note were rescinded but the Commission continued its policy of not requiring registration in the case of mergers. Since 1951 mergers have been excluded from the coverage of the registration provisions by the Commission's Rule 133 under the Securities Act, 17 CFR 230.133. The Commission's release adopting Rule 133 states:

> "As a matter of statutory construction the Commission does not deem the 'no sale theory' which is described in the rule as being applicable for purposes of any of the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934."

Securities Act Release No. 3420, p. 1 (1951). See also Securities Act Release Nos. 3698 (1956), 3762 (1957); E.I. DuPont de Nemours and Co., 34 S.E.C. 531, 533 n. 2 (1953); 1 Loss Securities Regulation 520-21 (2d ed. 1961).

It has been pointed out that under the Securities Act of 1933 "the word 'sell' may have a narrower meaning . . ." in the registration provisions than in other sections of that Act. See Schillner v. H. Vaughan Clarke & Co., 134 F. 2d 875, 878 (C.A. 2, 1943). The court there pointed out:

> "The broad definition set out in Section 2 [of the Securities Act, 15 U.S.C. 77b] is to be accorded 'unless the context otherwise requires.'"

The exemption from registration for certain judicially-approved reorganizations in Section 3(a)(10) of the Securities Act, 15 U.S.C. 77c(a)(10), suggests that at least in the absence of a rule, even under the registration provisions a merger may be considered a sale of securities. In this connection, the House Report on the Securities Act stated with respect to this provision as it appeared in an earlier draft:

> "Reorganizations carried out without such judicial supervision possess all the dangers implicit in the issuance of new securities and are, therefore, not exempt from the Act. For the same reason the provision is not broad enough to include mergers or consolidations of corporations entered into without judicial supervision." H. Rep. No. 85, 73d Cong., 1st Sess. (1933), p. 16.

aware no appellate court has directly dealt with the question whether the Commission's long-standing interpretation that the antifraud provisions of the securities laws are applicable to mergers and consolidations and should be upheld.[22/] We urge this Court to adopt the Commission's position to the end that the antifraud provisions of Section 10(b) and Rule 10b-5 will be available to protect public security holders, as we believe Congress intended, whenever they are required to make investment decisions which will result in a change in their securities holdings.

B. Defendants' Failure to Disclose that National Securities Intended to Reimpose the Payment of the Liabilities It Had Agreed to Assume as Part of the Consideration for Its Purchases of Producers Life Treasury Stock Constituted a Violation of Section 10(b) and Rule 10b-5

As we noted above (pp. 5-6), defendants did not disclose to Producers Life or its shareholders at the time National Securities purchased the treasury stock of Producers Life that the defendants did not intend to pay a major portion of the purported consideration. Aside from the $2.29 per share in cash, the balance of the consideration consisting of National Securities' assumption of certain of Producers

---

22/ Two cases are pending in the Courts of Appeals from the decisions of two district courts which have taken a position contrary to the Commission. Dasho v. The Susquehanna Corporation (N.D. Ill., No. 65 C 1757, April 15, 1966, rehearing denied, June 28, 1966), appeal pending, (C.A. 7); Vine v. Beneficial Finance Co., Inc., 252 F. Supp. 212 (S.D. N.Y., 1966), appeal pending, (C.A. 2). Other district courts which have considered the question have agreed with the Commission. Simon v. New Haven Board & Carton Co., 250 F. Supp. 297 (D. Conn., 1966); Voege v. American Sumatra Tobacco Corp., 241 F. Supp. 369 (D. Del., 1965); Securities and Exchange Commission v. Anaconda Lead & Silver Co. (D. Colo., No. 6819, July 11, 1961). Contra, Sawyer v. Pioneer Mill Co., 190 F. Supp. 21 (D. Hawaii, 1960), vacated as moot, 300 F.2d 200 (C.A. 9, 1962), certiorari denied, 371 U.S. 814 (1962). Cf. H. L. Green Co. v. Childree, 185 F. Supp. 95 (S.D. N.Y., 1960).

Life's liabilities in the amount of $12.50 per share was to be reimposed upon the successor of Producers Life when the consolidation became effective. Such non-disclosure comes within the prohibitions of Rule 10b-5 respecting omissions "to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . ." or respecting an "act, practice, or course of business which operates or would operate as a fraud or deceit upon any person. . . ." Fraudulent statements made in connection with the consideration given in a securities transaction have been held by this Court to consitute a violation of Section 10(b) and Rule 10b-5. Errion v. Connell, supra, 236 F.2d at 454 (1956). And, even if there is total non-disclosure, Rule 10b-5 may be violated. See List v. Fashion Park, Inc., 340 F.2d 457, 461-462 (C.A. 2, 1965), certiorari denied, 382 U.S. 811 (1965).

Both the United States Courts of Appeals for the Fifth Circuit and for the Second Circuit have held that where a corporation has been fraudulently induced to issue its own shares, a violation of Section 10(b) and Rule 10b-5 has occurred. Hooper v. Mountain States Securities Corporation, supra, 282 F.2d at 200-203; Ruckle v. Roto American Corp., 339 F.2d 24, 26 (C.A. 2, 1964). See also New Park Mining Co. v. Cranmer, 225 F. Supp. 261, 266 (S.D. N.Y., 1963); Pettit v. American Stock Exchange, 217 F. Supp. 21, 25-26 (S.D. N.Y., 1963). That directors of Producers Life may have been aware that defendants intended to reimpose

the assumed liabilities upon the shareholders of the successor to Producers Life, does not affect the end result that a fraud has been committed upon Producers Life and its shareholders. Cf., Hooper v. Mountain States Securities Corporation, supra, 282 F.2d at 201; McClure v. Borne Chemical Co., 292 F. 2d 824, 834 (C.A. 3, 1961), certiorari denied, 368 U.S. 939 (1961). But cf., O'Neill v. Maytag, 339 F. 2d 764 (C.A. 2, 1964).[23/]

* * *

In the light of the "broad fiduciary duties on management vis-a-vis the corporation and its individual stockholders" imposed by Section 10(b) of the Act, as implemented by Rule 10b-5,[24/] it would be unfortunate if this Court should hold that the terms "sale" and "purchase" must be so narrowly construed that the Act and Rule fail to implement the congressional intent to prohibit the type of fraudulent scheme here alleged.

23/ While we submit that O'Neill v. Maytag was wrongly decided, we believe that it is distinguishable since in that case the court found that all of the directors had participated in the alleged fraud. Here the Commission's Amended and Supplemental Complaint (R. 430) did not allege that all of the directors were aware of defendants' unlawful scheme. Indeed, one director, J. Grant Iverson, was not even present at the meeting of April 27, 1964, at which the sale of the treasury stock was authorized. See Ruckle v. Roto American Corp., supra, 339 F.2d at 26-27, where the court held that the corporation had been deceived when the majority of the board of directors withheld current financial information from a fellow director and failed to disclose other material facts to him.

24/ McClure v. Borne Chemical Co., supra, 292 F.2d at 834.

CONCLUSION

For the foregoing reasons the judgment of the district court should be vacated and the case remanded to that court for further proceedings.

Respectfully submitted,

PHILIP A. LOOMIS, JR.
General Counsel

DAVID FERBER
Solicitor

W. STEVENS TUCKER
Special Counsel

EDWARD B. WAGNER
Special Counsel

Securities and Exchange
Commission
San Francisco, California
94102

MARTIN D. NEWMAN
Attorney

Securities and Exchange
Commission
Washington, D. C. 20549

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

_____
David Ferber
Solicitor

February 1967

APPENDIX

Securities Exchange Act of 1934, 15 U.S.C. 78a, et seq.:

* * * *

Definitions and Application of Title

SECTION 3. (a) When used in this title, unless the context otherwise requires—

* * * *

(13) The terms "buy" and "purchase" each include any contract to buy, purchase, or otherwise acquire.

(14) The terms "sale" and "sell" each include any contract to sell or otherwise dispose of.

* * * *

REGULATION OF THE USE OF MANIPULATIVE AND DECEPTIVE DEVICES

SECTION 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange--

* * * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

* * * *

INVESTIGATIONS; INJUNCTIONS AND PROSECUTION OF OFFENSES

SECTION 21.

* * * *

(e) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this title, or of any rule or regulation thereunder, it may in its discretion bring an action in the proper district court of the United States, the United States District Court for the District of Columbia or the United States courts of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this title.

* * * *

Jurisdiction of Offenses and Suits

SECTION 27. The district courts of the United States, the United States District Court for the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this title or rules and regulations thereunder, or enjoin any violation of such title or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 225 and 347). No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts.

2. McCarran-Ferguson Insurance Regulation Act, 15 U.S.C. 1011-1015:

* * * *

Section 1012, 15 U.S.C. 1012:

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, that after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

* * * *

3. Rule 10b-5 under the Securities Exchange Act of 1934, 17 CFR 240.10b-5:

EMPLOYMENT OF MANIPULATIVE AND DECEPTIVE DEVICES

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.